the trial lawyers, if that were possible. The "Great American Pants Suit" was such a case, and its denouement yesterday was a bow to judicial sanity.

In 2005, Roy Pearson, an administrative law judge in Washington, D.C., took a pair of pants to his neighborhood dry cleaners for a $10.50 alteration; the pants may or may not have been misplaced. Mr. Pearson sued the proprietors, Jin, Soo and Ki Chung, claiming that their "Satisfaction Guaranteed" sign entitled him to between $54 million and $67 million in damages, including $2 million for mental suffering. He turned down a $12,000 settlement offer and noted, "Never before in recorded history have a group of defendants engaged in such misleading and unfair business practices." Gosh.

Judge Judith Bartnoff's 23-page decision in Mr. Pearson's non-jury trial dismantles his claims. She says his case was pursued "without regard to the facts or to any

that an officer of the court was forced to sift through the minutiae of claim tickets and pinstripes is itself a case for tort reform.

No doubt the missing pants will take their place in the twilight zone of American over-litigiousness alongside such injustices as spilled coffee and "toothbrush abrasion." There are, however, serious lessons here. Judge Bartnoff ordered Mr. Pearson to pay the Chungs' miscellaneous court costs, such as filing fees, though not their actual legal bills, which run to the tens of thousands of dollars. She may do so at a later date, but if not, the Chungs will have to counter-sue. "Loser pays" rules would curb frivolous suits in the future.

More to the point—and incredibly—Mr. Pearson arrived at his $67 million using a compensation formula prescribed by D.C.'s consumer protection laws. The judicial system wouldn't be subjected to so many junk lawsuits if it weren't so easy.

Road Blockhead

Mr. Oberstar protects his transportation pork.

In a testy letter to no fewer than all 50 states, House Transportation Chairman James Oberstar recently warned officials against entering public-private partnerships for local road projects and said he may even "undo" existing agreements. Sounds like the Minnesota Democrat feels threatened.

Public-private partnerships, or PPPs, are collaborations between a public agency and a private entity to fund highways and other infrastructure projects. They can cover the operation and maintenance of existing roads, or the construction of entirely new ones. Two of the country's most prominent PPPs are the Chicago Skyway and Indiana Toll Road. These deals have proliferated in recent years, and today more than 20 states allow private enterprises to operate toll lanes and toll roads. Tired of waiting on federal funds, states from Texas to Georgia to Virginia have used PPPs to modernize roadways and alleviate congestion.

In a follow-up to his ungentle missive, Mr. Oberstar released a "position paper" this month that fleshes out his "serious concern" that these arrangements "do not adequately protect the public interest." In reality, Mr. Oberstar's main concern is protecting the political interests of himself and fellow Transportation Committee Members. All 75 of them—about one-sixth of the entire House.

His committee is by far Congress's most bloated, and its main order of business is shepherding through the lard-ridden highway bill every six years. Road financing got federalized back in the 1950s for the purposes of building the Interstate Highway System. Today that system is nearly complete, and Transportation has become little more than a public works committee, with the highway bill serving as a vehicle for Members to hand out checks to favored constituents.

The last highway bill cost $295 billion, a third larger than its predecessor, and included 6,400 "special projects"—bike paths, museums, snowmobile trails, parking lots—that totaled $23 billion. These days, when the money does go toward actual road construction, it is often of the "Bridge to Nowhere" variety. Which is why states are finding public-private funding more and more attractive.

The biggest problem with the Interstate Highway System today is not connecting one city to the next; it's accommodating suburbanites forced to commute to a downtown area in bumper-to-bumper traffic. But that situation might not be a priority for the person who's got the pull to get money from the feds. Hence, PPPs have become an attractive alternative for financing new capacity projects, and that's what worries Mr. Oberstar. If this continues, he knows PPPs will make his committee less relevant in the transportation debate.

Notwithstanding the Congressman's self-interest, however, the more public-private partnerships, the merrier. Revenues from gas taxes, which support the highway fund, aren't enough to maintain the system, let alone finance expansions. Making all Americans pay for local road projects is unfair in any case. PPPs offer taxpayers more efficiency and accountability. And if local policy makers can involve the private sector in paying for highway projects, there's less incentive to raise taxes to fund new roads. No wonder Mr. Oberstar is against them.

Fixing

The t
p

By Ron Wyden
And Bob Bennett

It's been 13 years since the Senate has tal bipartisan health-care reform. And sor lieve it will be at least that long befor form worthy of the label is passed by Congress.

But even in Washington change is possible. Today we hope to demonstrate this as the Senate Budget Committee takes up our proposal to create a universal ket-driven health-care system that all Ame can afford. What we want is not for Washi to meddle in health-care decisions, but for American to receive the same level of care able to members of Congress now.

Too often in our nation's capital, necess forms are put on a shelf and left there. That' pening with health care, as many inside Wa ton would rather wait for a new president new Congress before enacting anything. Bu consistently show that waiting isn't what A cans want. And we're with those who sa don't want us to sit around for two years. N the perfect time to act and we offer our pr as a good-faith effort to pass serious healt reform before Election Day 2008.

Here's how our legislation, the Healthy A cans Act, would work: All Americans, othe those in Medicare or the military, would be incentives to buy basic private health plans viduals at or below the poverty level wou ceive a subsidy to buy insurance. And s would be given more flexibility (within a fe framework) to give consumers more choices surance available on the private market.

These reforms would make health insu portable (Americans could take it to whereve work) and make access to health care uni and affordable. They would also give indivi more control over where their health-care d go. And they would break the link between h insurance and employment, freeing employe burden they've carried since World War II and price controls forced them to offer health fits instead of pay raises.

How would this be possible? Currently t code gives the affluent the biggest health breaks. Our bill would rewrite the code to gi ery individual a tax benefit for buying heal surance. That would create an incentive to b surance. That, in turn, would push the heal surance industry to offer more competitive and create a more dynamic insurance mar

Our bill also includes an unprecedented of new incentives to promote personal respor ity and preventative medicine. These include ering Medicare Part B premiums for seniors change their behavior to lower their blood sure and cholesterol, as well as reducing f premiums for parents who enroll their child preventative health programs. And there a government mandates. We provide carro stead of sticks. Our bill also reforms the insu market so insurers compete on price, benefit quality, rather than simply signing up the he est Americans and side-stepping the sickes

Amazingly, creating a more rational he care market may also save money. The I Group, the gold standard of independent, h

WSJ Tuesday, June 26, 2007 pg. A14

THE DAILY NEWSPAPER OF PUBLIC FINANCE

P3s Divides Continue

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Posted on Friday, June 08, 2007
Source: Bond Buyer

by Humberto Sanchez

The Democratic leader of a congressional panel and a top U.S. Department of Transportation official butted heads yesterday over the merits and pitfalls of public-private partnerships and the extent to which they will play a role in meeting the nation's growing transportation needs.

At a hearing on alleviating traffic congestion, Rep. Peter DeFazio, D-Ore., took issue with DOT's advocacy of P3s, calling it biased and complaining it reflects the conservative views of the administration and think tanks, such as the Heritage Foundation.

"It just seems like one-sided advocacy here, like we are making transportation policy out of the Heritage Foundation and that is not going to be acceptable to a majority of the people in the Congress or the United States of America," said DeFazio, chairman of the House Transportation and Infrastructure Committee's highways and transit subcommittee, which convened hearing.

As chairman of the subcommittee DeFazio, will play a major role in drafting legislation to replace a current law that authorizes funding for the nation's transportation programs and expires at the end of fiscal 2009.

DeFazio said he believes that P3s have a potential for benefits, "small as they are," but warned that they are no substitute for increased federal spending on transportation infrastructure. DeFazio and full committee chairman James L. Oberstar, D- Minn., support increasing the federal gas tax to provide more revenue for transportation. The White House opposes such tax increases.

Jeffrey N. Shane, DOT under secretary for policy, defended the agency's position by pointing out that there is a limit to how much federal funding can be provided for transportation, regardless of what party is in the majority, and that private sector funding therefore must play an integral role in improving the nation's transportation infrastructure.

"I predict that no future administration is going to come out very differently on the issue of public financing of transportation," Shane said. "We know the entitlement programs are simply overwhelming our budget... . There simply has got to be discipline of the use of government funds and that is going to be a fact of life for every future administration, not just this one."

"When, in fact, there are so many alternative ways of funding transportation assets ... that actually makes them more productive, it is difficult to understand why there is so much controversy," he said.

The DOT has been urging states in recent years to pursue P3s as a way to improve transportation infrastructure. P3 deals involve contracts between

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public agencies and private entities that allow for greater private-sector participation in the design, construction, financing, and operation of infrastructure projects. P3s have been extensively used overseas, and top officials in the Bush administration believe that the private deals could be successfully used in the United States where transportation infrastructure is typically funded through federal, state, and local gas taxes and other related fees.

DeFazio said one danger is that the tolling associated with **P3** deals could price out low- and middle- income commuters. His comments come after Oberstar and DeFazio released a position paper earlier this week outlining their concerns with P3s.

Shane said he agreed with many points made in the paper but added: "We happen to think that there are hundreds of millions of [private sector] dollars ... available for transportation infrastructure that we should tap."

"We do have to calibrate these tools" he said. Shane noted that P3s have had success in other countries. "We just wonder why it is that we are having so much difficulty marching in the same direction here," he said.

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PUBLIC INTEREST CONCERNS OF PUBLIC-PRIVATE PARTNERSHIPS

OVERVIEW

The United States national transportation system is designed to provide trade corridors for the movement of goods from coast to coast, fort-to-port connections for military personnel and materiel, long-distance recreational travel, local delivery (becoming more prominent due to rapidly rising e-commerce), and local and regional personal mobility.

During the second half of the 20th Century, the system has successfully met the diverse transportation needs of the national economy and the American people. Cornerstones of the national transportation system are strong federal leadership and a robust federal-state partnership. But the system is facing very serious challenges that stem from explosive traffic growth, increased international trade, changing demographics, evolving travel patterns, and insufficient funding.

Under the right circumstances and conditions, public-private partnerships ("PPPs") can lead to more efficient and effective construction, management, operation, and maintenance of transportation facilities. Where private financing is involved, PPPs can *supplement—but not provide a substitute for*—public investments in transportation improvements.

When a government agency considers contracting with a private company to renovate, construct, operate, maintain, manage, or finance a facility or system, there are many issues that must be examined.

<u>Paramount among these responsibilities must be preserving the integrity of our integrated national surface transportation system and protecting the public interest.</u>

Summary of Recommendations

Advancing Public Objectives

- States should regulate PPP toll facilities to provide private operators with a reasonable return on their investments while protecting the public from potential monopolistic price gouging, and ensuring that all needed maintenance will be provided throughout the life of the concession agreement.

- Revenues and proceeds generated from PPPs should be used only for projects to enhance transportation safety, capacity, and mobility, preferably within the corridors from which they are generated.

- States should not include "non-compete" clauses in PPP concession agreements that limit state and local governments' ability to meet the current and future mobility and safety needs of the traveling public.

- To ensure the flexibility needed by future governments to meet changing conditions, PPP agreements should not extend beyond the design life of the facilities; they should be structured to be as short as possible.

- State transportation agencies, to the maximum practical extent, should develop and maintain independent, competent, in-house capabilities to negotiate with private-sector firms, to get the best value for the public in PPPs.

- States should ensure that PPP agreements do not result in environmental degradation, deny access to transportation by segments of our society, or otherwise undermine broadly supported social and public policy goals. Low-income drivers should be provided relief from high tolls charged for congestion pricing. The toll proceeds should be used to fund public transit and other highway alternatives for low-income individuals, in addition to maintenance of the facility and retirement of debt.

Maintaining the Integrity of the Transportation Planning Process

- States should enact enabling legislation that promotes timely distribution of relevant information to the public concerning proposed PPP projects and encourage open and full public participation throughout the review of the projects.

- States should enact enabling legislation that does not allow unsolicited PPP proposals, which do not go through the established planning process or open, competitive procurement. Private firms wishing to carry out projects under PPP arrangements should work with public authorities to develop projects consistent with the transportation improvement programs (TIPs, STIPs) and long-range plans.

Preserving an Integrated National Surface Transportation System

- PPPs should be pursued with vigorous federal oversight and coordination to produce a robust regional and national transportation system.

Public Interest Concerns

I. Advancing Public Objectives

A. Public-Private Partnerships Should Protect the Public from Monopolistic Pricing

<u>Recommendation</u>: PPP toll facilities should be regulated to provide private operators with a reasonable return on their investments while protecting the public from unreasonably high toll rates or excessive profits.

Background:
Toll facilities under public-private partnerships, like water and electric utilities, are government-sanctioned monopolies. They should be regulated as such to protect the public against abuses of monopoly power resulting in excessive tolls. Tolls should be set at a level which limits the operator to a reasonable return on investment.

Concession agreements that provide automatic toll escalation may result in tolls much higher than needed to produce a reasonable return on investment.

States should consider establishing a pre-determined return on the investment as part of PPP concession agreements. This would allow early conclusion of the agreements and control of the facility to be returned to the state ahead of schedule after the set total return on investment is attained.

B. Public-Private Partnerships Should Enhance Transportation Safety, System Capacity, and Mobility

<u>Recommendations</u>: Revenues and proceeds generated from PPPs should be used only for projects to enhance transportation safety, capacity, and mobility, preferably within the corridors from which they are generated.

Non-compete clauses, broadly defined, which limit state and local governments' ability to meet the mobility and safety needs of the traveling public, should not be included in PPP concession agreements.

Background:
Enhancement of safety, capacity, and mobility should be the primary objectives of a government's transportation policy, and hence of the public-private partnerships. Revenues and proceeds derived from PPPs should be used by the states for transportation improvement projects only, preferably within the same corridors from which the revenues are generated.

"Non-compete" clauses in concession agreements limit the ability of the state to improve roads and meet economic development objectives.

The most recent versions of the "non-compete" clause allow the state to go forward with projects that are included in the 20–year plan when the concession agreement is signed, but require reimbursement of the toll road operator if the state undertakes projects not in the plan that impair toll revenues. States implementing needed transportation improvements in the vicinity of toll facilities under such concession agreements therefore could find themselves facing severe financial strains to reimburse the private operators for their lost revenues.

States should be cautious in agreeing to these arrangements as they may significantly limit a state's ability to respond to changing needs by revising its transportation plans.

C. Public-Private Partnerships Should Preserve Flexibility in Future Decision-making

Recommendation: ***Terms of PPP agreements should not extend beyond the design life of the facilities; they should be structured to be as short as possible.***

Background:
Whether used to build new capacity (greenfield projects) or to turn existing public toll facilities into private operation (brownfield projects), public-private partnerships most often involve long-term concessions.

Recent leases of existing toll facilities in Illinois, Indiana, and Virginia involve concession agreements that run from 75 to 99 years. Recent concessions for new toll roads in California and Texas are for 45 and 50 years, respectively. Public control over these facilities with regard to operation, maintenance, and improvement has been ceded to the private firms for up to four generations.

Highways are important economic development tools for state and local governments. Extremely long leases of toll roads not only transfer control of the affected facilities to the private sector, they also limit, for generations to come, the ability of state and local governments to develop the wider regions through which the toll roads run. European experience shows that political leverage by public agencies over their private-sector partners in PPPs dissipates very rapidly, and is virtually exhausted about 10 years into a concession agreement.

Long-term concessions may provide substantial savings in public spending or upfront cash infusion, but this mortgaging scheme shifts the burden of paying for the facilities to future generations. Moreover, long term concessions severely limit the ability of future governments of states and localities to make rational decisions to adapt to changing circumstances.

D. Public-Private Partnerships Should Promote an Equitable Sharing of Risks and Rewards

Recommendation: State transportation agencies, to the maximum practical extent, should develop and maintain independent, competent, in-house capabilities to negotiate with private-sector firms in order to get the best value for the public in public-private partnerships.

Background:
When private firms participate in transportation investments, varying degrees of risks are shifted to those firms in exchange for an opportunity to earn financial rewards.

To ensure that the risks are shifted to the partner that can best handle them, and that the rewards earned are commensurate with the risks assumed, states need to develop independent, in-house capabilities to negotiate with, and oversee the operations of, private-sector firms.

Many project sponsors rely on outside advisors to provide assistance in their analysis and negotiations of proposed public-private partnerships. This may be a problem because of serious potential conflicts of interest. Wall Street analysts have posited the hypothetical example of a firm that is providing financial advice to a state involved in PPP negotiations while simultaneously engaging in investment banking for the same deal. With rapidly growing interest in PPPs in the United States among investment banking firms that also provide financial advice to the states, this hypothetical situation is quite real. In such a situation, there must be strong firewalls separating the financial advice from investment banking to prevent conflicts of interest.

Even firewalls may be inadequate, since the high financial stakes involved will create strong incentives to breach the firewalls.

Moreover, even advisors with no other line of business or no private-sector client may still fail to adequately represent a state in PPP negotiations. The advisor may not want to alienate private-sector firms, which may want to use the advisor in future PPP deals.

If outside advisors must be used, states should impose and enforce a code of ethics requiring the advisors to provide full disclosure of formal and informal business relationships with any potential bidders, enter into confidentiality agreements with the public agencies, and agree to a ban of meaningful duration from representing private-sector bidders.

E. Public-Private Partnerships Should Protect Workers, the Environment, Small Businesses, and Low-Income Drivers

Recommendation: ***In developing the terms of PPPs, state transportation agencies should ensure that the agreements do not result in environmental degradation, denial of opportunities or access to segments of our society, or otherwise undermine broadly supported social and public policy goals. Low-income drivers should be provided relief from high tolls charged for congestion pricing. The toll proceeds should be used to fund public transit and highway alternatives for low-income individuals.***

Background:
Federal assistance for highway development is provided under the Federal-aid Highway Program that imposes requirements regarding prevailing wages (Davis-Bacon), assistance for small and minority-owned businesses (disadvantaged business enterprises), environmental review (NEPA), air quality improvement (clean air conformity), environmental mitigation (wetlands), resource conservation (4(f), endangered species), domestic job and industrial base protection (Buy America), and accommodation for the disabled (ADA). These requirements are intended to help achieve specific social and public policy goals that are widely accepted. States should not attempt to avoid these requirements by segmenting projects and funding selected portions with only non-federal funds.

Tolls charged for the use of a transportation facility under a public-private partnership arrangement are regressive; the higher the tolls—such as the high tolls that would be charged in congestion pricing—the greater the negative impact on low-income drivers. These impacts should be mitigated. Electronic toll collection makes it feasible to reduce or eliminate the tolls paid by low-income drivers.

Some low-income drivers may wish to switch to public transportation services because congestion pricing tolls are too high to be affordable. To accommodate these needs, states should use some portion of the toll proceeds to fund the public transit and highway alternatives for low-income individuals.

II. Maintaining the Integrity of the Transportation Planning Process

A. Public-Private Partnerships Should Preserve the Planning Process and Public Participation in Project Review

Recommendation: States should enact enabling legislation that promotes timely distribution of relevant information concerning proposed PPP projects to the public and encourages open and full public participation throughout the review of the projects.

Background:
Federal environmental and transportation law requires detailed transportation planning by the states and metropolitan planning organizations. The plan must be developed through a transparent public process that promotes full participation by all stakeholders. The final planning documents—the transportation improvement program ("TIP"), state transportation improvement program ("STIP"), and long-range transportation plan—are designed to reflect the collective views and vision of the community. Individual projects included in these documents must also undergo vigorous review.

Some states have enacted laws authorizing public-private partnerships that also limit the timely dissemination of information about the projects. Allowing PPP projects to avoid the full public review process will undercut the transparency and opportunity for public participation in the transportation planning and project review processes.

B. Public-Private Partnerships Should Reflect and Follow State and Local Transportation Priorities

Recommendation: States should enact enabling legislation that does not permit unsolicited PPP proposals which may undercut or circumvent the planning process or distort open, competitive procurement. Private firms wishing to carry out projects under PPP arrangements should work with public authorities to develop projects consistent with the transportation improvement programs (TIPs, STIPs) and long-range plans.

Background:
Some states have enacted, or are considering, laws to permit the submission of unsolicited proposals by private firms for transportation projects. These laws would require public transportation agencies to review the proposals within specified timeframes, and to go forward if the proposed projects are determined to be feasible.

The transportation planning process is designed to establish local and state transportation priorities, without regard to whether individual projects are financially profitable or not. Allowing unsolicited private proposals to bypass the transportation planning process seriously impairs the process. The result could be that the fiscally constrained projects that are included in the TIPs, STIPs, and long-range plans will have to be pushed back to make room at the front of the queue for the financially profitable privately proposed projects. This rearrangement of publicly-determined priorities undermines the established transportation planning process and, consequently, substantial taxpayer investment in transportation planning is squandered.

States must ensure that public-private partnerships do not undermine the planning process, which ensures that priority will be given to the public interest, not the desire of profits.

III. Preserving an Integrated National Surface Transportation System

A. Public-Private Partnerships Should Help Advance the Goals of and Improve our National Transportation Program

Recommendation: ***PPPs should be pursued with vigorous federal oversight and coordination in the context of a robust regional and national transportation program.***

Background:
Our national transportation system is under tremendous stress, and needs to be improved. A fragmented national system cannot deal effectively with the challenges it faces. Performance of the overall system will deteriorate over time. If left uncorrected, it could lead to system failure. Public-private partnerships can play a role in meeting the needs to enhance our transportation system. However, they must be implemented in a manner that does not reinforce and exacerbate the fragmentation of the national transportation system.

Many of the needed improvements include facilities in more than one state, and the development of projects which are located only in one area but benefit large regions or even the entire nation.

If states with very diverse social, economic, and other requirements act in complete independence of one another, they will produce an uncoordinated and inefficient transportation system that will not even serve each state's individual needs, because of contradictory or inconsistent actions taken by neighboring states.

These tendencies will be accentuated by PPPs if there is not strong oversight to ensure that these projects are developed as part of an overall plan for a national transportation system which also meets the needs of each state. Unless appropriate planning and public interest protections are incorporated into the procedures of implementing PPPs, these transactions could stimulate and accelerate the devolution of the federal program to the states.

http://www.latimes.com/news/local/la-me-arnold2jun02,1,935918.story?ctrack=1&cset=true
From the Los Angeles Times

California's governor impressed by privatization he sees in Canada

As his push for that goal flags at home, Schwarzenegger sees one of many such projects to the north.

By Evan Halper
Times Staff Writer

June 2, 2007

VANCOUVER, CANADA — In a trip across Canada this week, as local leaders jostled one another to praise him as a statesman they could learn from, there was a moment when Gov. Arnold Schwarzenegger might have taken some notes of his own.

At a Vancouver construction site that he dropped by, workers were busily boring a tunnel for the type of public works project that the governor has been unable to get off the ground at home: one owned and operated entirely by a private company.

A 12-mile rail line that will connect Vancouver's waterfront to its airport is one of dozens of ventures like it in Canada. Provinces are turning to private companies to build and operate trains, roads, public hospitals, university facilities — even local schools.

"The way they do it is, I think, the right way to go," Schwarzenegger said in an interview. "We don't have to exactly copy it, but we can learn from those ideas."

He said that Wall Street is clamoring to invest in private infrastructure projects and that California must examine ways to "benefit from all the private money that is out there."

The governor has long championed the sort of large-scale privatization seen in Canada, calling it a solution to bureaucratic inertia and inefficiency in state government. Put services in the hands of the private sector, his argument goes, and the potential for profit will bring a new urgency to providing for the public.

But as other governments in North America and elsewhere move swiftly ahead with such plans, Schwarzenegger's privatization campaign is faltering.

Days before the Vancouver visit, a legislative committee unceremoniously dumped the governor's proposal to hire a few hundred private-sector engineers to help Caltrans with the cumbersome business of designing roads. Ideas he backed for building private toll roads, enlisting private firms to construct courthouses and contracting out more prison operations have stalled. A proposal to allow businesses to run freeway rest stops has been on the shelf for years.

"All new things take time for the legislators to really get familiar with," Schwarzenegger said with characteristic optimism. "We don't want to rush it and then make mistakes."

But proponents of the projects have grown dismayed as tens of billions of dollars in private investment have found a home elsewhere.

In places such as Canada and Britain, where medicine is socialized and big government has long been part of the political fabric, private companies are doing hundreds of infrastructure projects. Most involve private interests building a project for a government and then operating it for decades through a long-term lease.

In Schwarzenegger's case, "there has been a lot of rhetoric about this, then squat. Nothing happens," said Adrian Moore, vice president of research at the Reason Foundation, a Los Angeles think tank.

Moore worked with the Schwarzenegger administration to craft privatization plans soon after the governor was elected. But he has since become critical of what he sees as Schwarzenegger's reluctance to antagonize public employee unions.

"Canada is doing it, for crying out loud. I just spent 10 days in China, a communist country, and they are creating these partnerships right and left," Moore said. "They don't see this as some kind of mystical thing. They see it as a way to get things done."

But the Democrats who control California's Legislature have sided with public-employee unions that see privatization as a threat to tens of thousands of government jobs.

"Democrats — we're not in the business of contracting out state services," said Assembly Speaker Fabian Nuñez (D-Los Angeles). "It doesn't fit well with our political diet."

The only major privatization proposal Democrats have hinted they might embrace, albeit reluctantly, is not one that will get roads or rail lines built, or provide any other major construction: the governor's plan to turn the lottery over to a private company. Democrats are attracted by the billions of dollars such a deal could generate, money that could be spent on government programs.

The last time Schwarzenegger tried to overhaul the state bureaucracy in the face of intense labor and Democratic opposition, he emerged battered. He abandoned one plan, a 2005 scheme to shift state pensions for new government workers to a 401(k)-style program — a move that could have involved private financial managers in public retirement accounts — after opponents said it threatened death and disability benefits for public safety officers.

Now, the governor says, he won't demand privatization of public works until "the state is serious about this."

He said he wants to be sure "that people are not going to put up roadblocks to show those things don't work.... We're just going to have to move forward slowly and carefully and do it the right way."

Opponents of privatization say it simply doesn't work. Unions point to failed experiments that ended with projects not completed on time, services deteriorating and tax dollars wasted.

One is a recent bid by Texas to privatize welfare enrollment. State officials accused a private consortium of bungling the project, which dropped more than 30,000 children from health insurance rolls in a six-month period. The state pulled the plug on the contract a few weeks ago.

In Nova Scotia, where private companies were hired to build and maintain 30 local school buildings, the government ultimately determined it could have saved tens of millions of dollars by doing the job itself.

But many governments have found ways to structure their contracts so that if a project is not completed on time or fails to provide the promised level of service, it is investors rather than taxpayers who get stuck with the bill. Most projects in Canada include such provisions.

"It is very rare that they come in late or over budget. If they do, the private company eats the costs," said Jane Peatch, executive director of the Canadian Council for Public Private Partnerships.

Among the successes is a $1-billion bridge, built by a private company, linking Prince Edward Island to New Brunswick. A hospital in Vancouver was built and is maintained by a private company; government and university doctors provide care.

A privately built water treatment facility was completed $10 million under budget, and several sections of roadway throughout the country have been built and are maintained by private firms.

At a makeshift conference table under a canopy at the Vancouver construction site Thursday, British Columbia Premier Gordon Campbell told the governor that within a decade every major infrastructure project in his province will be built and managed by private interests.

David Crane, the governor's chief economic advisor who was also at the table, said: "California is way behind."

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evan.halper@latimes.com

JAMES L. OBERSTAR, CHAIRMAN

U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

May 10, 2007

Dear:

We write to strongly discourage you from entering into public-private partnership ("PPP") agreements that are not in the long-term public interest in a safe, integrated national transportation system that can meet the needs of the 21st Century. Although Bush administration officials have lauded PPPs at every turn, the Committee on Transportation and Infrastructure of the U.S. House of Representatives believes that many of the arrangements that have been proposed do not adequately protect the public interest. The Committee will work to undo any state PPP agreements that do not fully protect the public interest and the integrity of the national system.

The Committee on Transportation and Infrastructure has begun work on reauthorizing the Federal highway, transit, and highway safety programs of Safe, Accountable, Flexible, Efficient Transportation Equity Act: a Legacy for Users ("SAFETEA-LU"), which expires on October 1, 2009. We believe that we must significantly increase investments in our highway, bridge, and public transit infrastructure. However, we have serious concerns about states entering into PPP agreements that improve selected segments of our surface transportation network but undermine the integrity of a national system and do not protect the public interest. Although we invite all financing options be on the table as we evaluate opportunities to increase investment in our nation's infrastructure, we strongly caution you against rushing into PPPs that do not fully protect the public interest, the integrity of the national system, and which do not constitute a sustainable national system of transportation financing.

The Subcommittee on Highways and Transit of the Committee has held three hearings since May of 2006 on PPPs to examine the policy questions surrounding increased private involvement in infrastructure project development, delivery, and financing. It will hold another hearing on the issue at the end of the month. Our interest in PPPs is directly related to the increased involvement of private companies, both foreign and domestic, in managing and financing our nation's transportation infrastructure, and efforts by the U.S. Department of Transportation ("U.S. DOT") to strongly encourage states to utilize PPPs.

Our concern initially stemmed from non-compete clauses that are frequently included in concession agreements that make it extremely difficult – if not impossible – for public transportation agencies to address safety and congestion problems on highways and streets adjacent to private toll roads. More recently, we have become increasingly concerned with a new type of PPP agreement that was approved for projects in Chicago and Indiana. These agreements raise revenues for public entities by engaging in long-term leases of existing toll facilities with private companies. These deals make good business sense to the companies that are investing in the projects, but we have serious concerns about whether these transactions offer a net balance of benefits for the American public.

We are also very concerned about the impact that PPPs will have on our national transportation network, which is the mobility backbone that supports our economy. Our Federal-aid highway system was developed on the basis of a federal-state partnership. The need for an efficient, integrated national transportation network is even more compelling in today's global economy than when we began the work in the 1956. Shortsighted and unbalanced PPPs that mortgage our nation's surface transportation infrastructure for generations to come may favor parochial and private interests to the detriment of an improved 21st Century national transportation system.

The rush of the Administration and some states to embrace PPPs, particularly for long-term leases of existing assets, is already turning public opinion against this form of innovative financing and may hurt future efforts to positively harness private investment for the public good. PPPs that expand capacity and provide a service that otherwise cannot be provided by public resources may be a good idea. However, we need to fully examine both the claimed benefits and the potential public policy concerns engendered by this relatively new way of financing transportation projects in the United States before it is significantly expanded across the country.

The U.S. DOT is strongly encouraging states to adopt legislation allowing for PPPs. To support this endeavor, they have created "model legislation" for the states as an example of what the Administration believes should be included in any legislation proposal to authorize PPPs. To provide a more balanced discussion about the benefits and costs of PPPs, the Committee on Transportation and Infrastructure is preparing a discussion paper that outlines what we think states should consider before enacting PPP legislation or entering into PPP agreements. That document will be sent to you in the coming days.

As we move to reauthorize the Federal highway, transit, and highway safety programs, we look forward to working with you and other state and local officials to ensure that we significantly increase infrastructure investment while protecting the public interest in a safe, integrated national transportation system that can meet the needs of the 21st Century.

If you have any questions, please contact the majority staff of the Subcommittee on Highways and Transit at (202) 225-9989 or us.

With all best wishes.

Sincerely,

Jim Oberstar

James L. Oberstar, M.C.
Chairman

Peter A. DeFazio, M.C.
Chairman
Subcommittee on
Highways and Transit

BusinessWeek

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MAY 7, 2007

COVER STORY
By Emily Thornton

Roads To Riches

Why investors are clamoring to take over America's highways, bridges, and airports—and why the public should be nervous

COVER STORY PODCAST

Steve Hogan was in a bind. The executive director of Colorado's Northwest Parkway Public Highway Authority had run up $416 million in debt to build the 10-mile toll road between north Denver and the Boulder Turnpike, and he was starting to worry about the high payments. So he tried to refinance, asking bankers in late 2005 to pitch investors on new, lower-interest-rate bonds. But none of the hundreds of investors canvassed was interested.

Slide Show >>

Then, one day last spring, Hogan got a letter from Morgan Stanley (MS) that promised to solve all of his problems. The bank suggested Hogan could lease the road to a private investor and raise enough money to pay off the whole chunk of debt. Now Hogan, after being inundated with proposals, is in hot-and-heavy negotiations with a team of bidders from Portugal and Brazil. "We literally got responses from around the world," he says.

Slide Show >>

In the past year, banks and private investment firms have fallen in love with public infrastructure. They're smitten by the rich cash flows that roads, bridges, airports, parking garages, and shipping ports generate—and the monopolistic advantages that keep those cash flows as steady as a beating heart. Firms are so enamored, in fact, that they're beginning to consider infrastructure a brand new asset class in itself.

With state and local leaders scrambling for cash to solve short-term fiscal problems, the conditions are ripe for an unprecedented burst of buying and selling. All told, some $100 billion worth of public property could change hands in the next two years, up from less than $7 billion over the past two years; a lease for the Pennsylvania Turnpike could go for more than $30 billion all by itself. "There's a lot of value trapped in these assets," says Mark Florian, head of North American infrastructure banking at Goldman, Sachs & Co (GS).

There are some advantages to private control of roads, utilities, lotteries, parking garages, water systems, airports, and other properties. To pay for upkeep, private firms can raise rates at the tollbooth without fear of being penalized in the voting booth. Privateers are also freer to experiment with ideas like peak pricing, a market-based approach to relieving traffic jams. And governments are making use of the cash they're pulling in—balancing budgets, retiring debt, investing in social programs, and on and on.

But are investors getting an even better deal? It's a question with major policy implications as governments relinquish control of major public assets for years to come. The aggressive toll hikes embedded in deals all but guarantee pain for lower-income citizens—and enormous profits for the buyers. For example, the investors in the $3.8 billion deal for the Indiana Toll Road, struck in 2006, could break even in year 15 of the 75-year lease, on the way to reaping as much as $21 billion in profits, estimates Merrill Lynch & Co. (MER) What's more, some public interest groups complain that the revenue from the higher tolls inflicted on all citizens will benefit only a handful of private investors, not the commonweal (see BusinessWeek.com, 4/27/07,

"A Golden Gate for Investors").

There's also reason to worry about the quality of service on deals that can span 100 years. The newly private toll roads are being managed well now, but owners could sell them to other parties that might not operate them as capably in the future. Already, the experience outside of toll roads has been mixed: The Atlanta city water system, for example, was so poorly managed by private owners that the government reclaimed it.

Such concerns weigh on the minds of public officials like Hogan. He intends to negotiate aggressively with corporate suitors and has decreed that the buyer must share future toll-hike revenues with the local governments that built the highway. But with the market for infrastructure still in its infancy, every deal is different. The ideal blend of up-front payment, toll hikes, and revenue sharing hasn't been found.

FLOOD OF MONEY

The nascent market in roads and bridges in the U.S. follows the shift toward privatization in Europe and Australia that began with British Prime Minister Margaret Thatcher in the 1980s. It took longer to develop in the U.S. because of the $383 billion municipal bond market, which has been an efficient source of capital for governments over the years.

But with the explosion of money flowing into private investments recently, fund managers have been exploring the fringes of the investing world in search of fresh opportunities. Now a slew of Wall Street firms—Goldman, Morgan Stanley, the Carlyle Group, Citigroup, and many others—is piling into infrastructure, following the lead of pioneers like Australia's Macquarie Group. Rob Collins, head of infrastructure mergers and acquisitions at Morgan Stanley, estimates that 30 funds are being raised around the world that could wield as much as $500 billion in buying power for U.S. assets.

Many investors think of infrastructure investing as a natural extension of the private equity model, which is based on rich cash flows and lots of debt. But there are important differences. Private equity deals typically play out over 5 to 10 years; infrastructure deals run for decades. And the risk levels are vastly different. Infrastructure is ultra-low-risk because competition is limited by a host of forces that make it difficult to build, say, a rival toll road. With captive customers, the cash flows are virtually guaranteed. The only major variables are the initial prices paid, the amount of debt used for financing, and the pace and magnitude of toll hikes—easy things for Wall Street to model. "With each passing week, there are more parties expressing unsolicited interest in some kind of a financial transaction that will involve one of our assets directly or indirectly," says Anthony R. Coscia, chairman of the Port Authority of New York & New Jersey.

Firms are even beginning to market infrastructure to investors as a separate asset class, safe like high-grade bonds but with stock market-like returns—and no correlation with either. The Standard & Poor's 500-stock index has returned about 10% a year, counting dividends, since 1926. Bonds have returned about 5%. Firms say infrastructure will beat both, and without having to sweat out market dips along the way. That's a huge selling point at a time when stock, bond, and commodity markets around the world are becoming increasingly interconnected.

Investors can't get in fast enough. They recently deluged Goldman Sachs with $6.5 billion for its new infrastructure fund, more than twice the $3 billion it was seeking. "We're using [infrastructure] as a fixed-income proxy," says William R. Atwood, executive director of the Illinois State Board of Investment, who plans to invest $600 million to $650 million, or 5% of its portfolio, in infrastructure funds over the next three years. "We're hoping to get 11% to 12% returns and lower risk." Pension funds in particular like the long-term investment horizons, which match their funding needs well. Infrastructure "delivers similar yield expectations to high-yield bonds and real estate, with less risk," says Cynthia F. Steer, chief research strategist at pension consulting firm Rogerscasey.

On the other side of the bargaining table from the investment firms sit struggling governments suddenly amenable to the idea of selling control of assets to solve short-term problems. The burden of maintaining roads, bridges, and other facilities, many built during the 1950s, is becoming difficult to bear. Federal, state, and local governments need to spend an estimated $155.5 billion improving highways and bridges in 2007, according to transportation officials, up 50% over the past 10 years. And that's hardly the only obstacle they face. In 2006 alone, states increased their Medicaid spending by an estimated 7.7%, to $132 billion. And state and local governments could be on the hook for up to $1.5 trillion in retiree liabilities, estimates Credit Suisse. At the same time, politicians find it difficult to raise taxes. Chicago's former chief financial officer, Dana R. Levenson, sums up the situation: "There is money to be had, and cities need money." U.S. Representative Chaka Fattah, a Pennsylvania Democrat who is running for mayor of Philadelphia, proposes to privatize the Philadelphia International Airport and use the proceeds to fund poverty programs—a much easier sell than a tax increase.

The combination of eager sellers and hungry buyers is shaking loose public assets across the country. The 99-year lease of the Chicago Skyway that went for $1.8 billion in 2005 was the first major transaction. Last year came the Indiana deal. Now states and cities are exploring the sale of leases for the turnpikes in New Jersey and Pennsylvania, a toll road in Texas, Chicago Midway Airport, and several state lotteries. Suddenly politicians around the country are wondering how much cash they might be sitting on. Based on the going rate of about 40 times toll revenues, the iconic Golden Gate Bridge could probably fetch $3.4 billion were California interested in selling. The Brooklyn Bridge? If permission were granted by New York City to charge the same tolls as the George Washington Bridge, a private owner might shell out as much as $3.5 billion for it.

PAVEMENT PRICING

But there's a downside to the quick cash: planned toll hikes that are usually quite aggressive. Chicago's Skyway could see car tolls rise from $2 in 2005 to $5 by 2017. For some perspective, if a similar scheme were applied to the Pennsylvania Turnpike during its 67 years of existence, the toll for traveling from the Delaware River to the Ohio border would be as much as $553 now instead of $22.75. Macquarie, which teamed up with Spain's Cintra to purchase the Chicago Skyway and the Indiana Toll Road, underscored the governmental trade-off during a presentation at the recent White House Surface Transportation Legislative Leadership Summit: "More Money or Lower Tolls." In an extreme scenario, governments could begin to sell properties that aren't tolled to private owners who will impose fees.

Of course, tolls won't go to the moon if they result in dramatic reductions in traffic. For example, investment firm NW Financial Group estimates that if the Chicago Skyway pricing scheme were applied to New York's Holland Tunnel over its 80 years, it would cost $185 to travel through it instead of the current $6. "No one will pay that much," says Murray E. Bleach, president of Macquarie Holdings (USA) Inc. "It's just not going to happen."

Still, Indiana legislators became so alarmed by promised hikes that they changed the terms before the toll road lease was completed. The state set aside $60 million to pay the difference in tolls for up to two years or until the buyers install electronic tolling equipment. After that, the fee for cars with electronic toll cards will rise to $4.80 over the full 157 miles, while the fee for cars without the cards will soar to $8. After 2010, both rates will rise each year by 2%, the pace of inflation, or the rate of economic growth, whichever is highest.

The certainty of future toll hikes doesn't jibe with the uncertainty of service quality. Assets sold now could change hands many times over the next 50 years, with each new buyer feeling increasing pressure to make the deal work financially. It's hardly a stretch to imagine service suffering in such a scenario; already, the record in the U.S. has been spotty. In 2003 the city of Atlanta ended a lease of its water system after receiving complaints about everything from billing disputes to water-main breaks. The city wrestled with the owner, United Water Inc., over basics like the percentage of water meters it should monitor. Both parties acknowledge that the contract lacked specifics. In the end, "we didn't believe we were getting performance," says Robert Hunter, commissioner for Atlanta's Dept. of Watershed Management. "I don't believe the city will ever look at privatizing essential services again." United Water says the contract wasn't financially feasible because Atlanta's water system was in worse shape than the city had represented.

A CHAMPION'S PERSPECTIVE

States are wrestling with other public policy issues, too. Bankers say New York could reap a combined $70 billion for long-term leases on a bunch of assets, including the state's lottery, the Tappan Zee Bridge, and the New York State Thruway. New York state officials have looked into the option of leasing the lottery, which itself might command $35 billion—a sum that could substantially upgrade, say, New York's higher education system. The downside? The state would probably have to remove constraints on the lottery's marketing designed to discourage people from gambling more than they can afford. If the state insists on keeping the constraints in place, it could reduce the value of selling it.

Chicago's experience shows the possibilities and the pitfalls of privatization. Former CFO Levenson has been one of the movement's biggest champions. He was an architect of the Skyway deal, which kicked off the market. Then he sold control of parking garages to Morgan Stanley for $563 million. Next, he started shopping around a lease for Midway Airport that could fetch as much as $3 billion. And soon the city hopes to auction off rights to operate some recycling plants. Levenson dismisses critics who argue that he has dumped prized assets. "This is not like where a person goes in and buys a loaf of bread from a store and walks out with that loaf of bread," he says. "Some entity, we expect, will make an offer to lease the Midway Airport for 75 to 99 years, and the following day I'm pretty sure it will still be there."

Wearing a crisp suit and stylish eyeglasses, Levenson looks like the Wall Streeter he once was, working for Bank One Corp. and Bank of America Corp. (**BAC**) before taking the Chicago city job in 2004. In April he returned to banking: As a managing director at the Royal Bank of Scotland Group (**RBS**), he now beats the bushes for infrastructure deals. Levenson doesn't understand how local governments can afford not to put public works up for sale. Thanks to the 99-year lease for the Skyway, Chicago has paid off its debt and handed over $100 million to social programs like Meals on Wheels. Plus, says Levenson, it's earning as much in annual interest on the $500 million it has banked from the transaction as it used to earn from running the Skyway ($25 million).

In some ways, Levenson argues, the city still has control over the highway. The agreement with the new owners spells out guidelines in mind-numbing detail, dictating everything from how quickly potholes must be filled (24 hours) to how rapidly squirrel carcasses must be removed (8 hours). If Macquarie and Cintra violate those conditions, the city can take back the road.

So far, the buyers have strictly adhered to the rules. At 7 a.m. on a Wednesday in March, five workers begin another day at the Chicago Skyway's Snow Command. On their to-do list are potholes to be checked and cracks to be sealed. Juan Rodriguez used to patrol the freeway for Chicago city. Today, he cruises the road for private owners. He discovers some potholes have grown unacceptably large because of salt that was spread the previous night. There's some tire debris that must be removed, and a disabled vehicle holding up traffic.

A SMOOTH RIDE?
In the past, Rodriguez says, he had to write out a ticket for each problem, which would be added to a long list of chores. Addressing problems often took days, Rodriguez recalls. But by 10:25 a.m., all of this morning's issues on the Skyway's 7.8-mile stretch of pavement are resolved. "The new owners are taking the Skyway to a whole new level," he says.

They've certainly spent money on improvements. The message "a clean workplace is a happy workplace" is scrawled on a whiteboard in a freshly painted and ventilated garage where workers meet. There's electronic tolling, which didn't exist before. A bunch of new lanes are under construction. The investments seem to be paying off: Since taking over two years ago, the Skyway's operators estimate traffic has risen 5%.

It's all encouraging, except that Chicago "probably could have gotten more without privatizing," according to Dennis J. Enright, a principal and founder of NW Financial. His firm's analysis shows that Chicago could have done a lot better by handling the whole deal itself. It could have raised tolls and sold tax-exempt municipal bonds backed by the scheduled hikes. That would have given the city the up-front cash it needed while preserving some of the income from the toll hikes. Instead, that money will go to Macquarie and Cintra.

Meanwhile, the higher tolls will take a big bite out of lower-income people's wallets. "You have to ask yourself if you want roads that used to be considered a public service to be rationed by income class," says Princeton University economics professor Uwe E. Reinhardt. Chicago says it hasn't received any formal complaints from citizens, though two different drivers recently went to extremes to avoid tolls, says Skyway maintenance manager Michael S. Lowrey. When the new owners introduced free towing for broken-down vehicles, the drivers called the Skyway for help, claiming to be stranded. After workers hauled the vehicles past the tollbooths, they hopped in their cars and sped away.

For workers, the privatization wave has wrought many changes. Skyway toll takers used to be full-time city employees with rich benefits. Now most are part-time independent contractors without benefits. Brian Rainville, executive director of the Chicago Teamsters Joint Council 25, helps manage the union's pension fund. When he listened to a recent pitch from a pension consultant about infrastructure funds, it sparked a realization: The returns he might generate for his pensioners could be canceled out by the union's shrinking number of contributors. "It's pretty obvious that it's not sound fiscal policy for the [pension] fund to undercut the people it's serving," Rainville says.

Pushback against private investors is now playing out in different ways elsewhere. In Pennsylvania, the state turnpike commission is going head-to-head with private bidders for the right to operate the state's 537-mile toll road. Pennsylvania desperately needs cash to repair its nearly 6,000 structurally deficient bridges. Some pundits expected Pennsylvania Governor Edward G. Rendell to propose hikes in gas taxes and other fees to fund the projects. But in December, Rendell unexpectedly announced plans to privatize the turnpike. Timothy J. Carson, vice-chairman of the commission, scrambled to submit an expression of interest for the turnpike to continue to run itself. His proposal is being judged against many others, including those from big Wall Street firms.

Carson isn't dissuaded by arguments that investors are better qualified to run turnpikes profitably. "There's no magic here," he says. "These [deals] are largely driven by one factor: the permitted toll increases." Carson says the state doesn't need to hand over the turnpike to private owners. Historically, he says, the state wanted the turnpike to collect only enough money to break even. But it could just as easily adopt its own toll-hike schedule. The state could also charge tolls on more roads. In other words, the public could remain in control simply by changing the turnpike's mission. That would ensure that the benefits of the toll hikes were spread throughout the populace, says Carson.

Pennsylvania's isn't the only turnpike authority exploring the possibility of bidding for roads. The North Texas Tollway Authority calculated in March that it would have valued a partially constructed 25-mile stretch of highway near Dallas 26% more than a private investor had bid. Now it's considering making a formal bid. And on Apr. 11, the Texas House of Representatives passed an amendment by a vote of 134 to 5 to impose a two-year moratorium on privatizing state toll roads. "We need to put the brakes on these private toll contracts before we sign away half a century of future revenues," said representative Lois W. Kolkhorst, who proposed the bill. A similar bill was passed in the state senate on Apr. 19.

With so much money at stake and so many options available to states, it's impossible to know how the great infrastructure craze may play out. But this much is certain, says Pennsylvania's Carson: "People are willing to pay more than they are currently being charged. The only question is to what extent you're willing to take advantage of that."

Click **here** to join a debate about private ownership of roads and bridges.

Thornton is as associate editor for *BusinessWeek*

The New York Times
nytimes.com

January 22, 2007

Illinois Seeks to Privatize Its State Lottery

By JENNY ANDERSON and CHARLES DUHIGG

The State of Illinois is seeking to privatize its state lottery system, hoping to attract as much as $10 billion from private investors interested in an operation with 800 retail outlets and 2005 revenue of about $650 million.

John Filan, Illinois' chief operating officer and until recently its chief budget officer, said private operators would bring a technological and marketing expertise to the lottery system that the government cannot provide.

"This is fundamentally a retail business, and governments are not equipped to manage retail businesses," said Filan. "Gaming is getting so competitive around the world that we're worried our revenues could go down unless there is retail expertise to run the lottery."

The deadline for bids is Feb. 20. Since 1974, according to the state, the lottery has contributed $13 billion to Illinois schools.

But the move to privatize the lottery is raising concern from public advocates.

Prior to the 20th century, almost all lotteries in the United States were operated privately. But a series of scandals involving political corruption rendered private lotteries illegal for nearly 100 years. State lotteries began to come back in the mid 1970s, and in 2005 they took in more than $52 billion, according to the North American Association of State and Provincial Lotteries.

Taking lotteries out of state hands could raise tricky social policy issues, as private operators will be interested in maximizing revenue without the sensitivity publicly elected officials face.

"As a government agency, lotteries are bound by the duty of care that a government has to its citizens," said Rachel Volberg, director of Gemini Research. "A private operator is not bound by any duty of care, just payments to the government. My concern would be that a private operator would be much more aggressive with advertising, with introducing new products that have addictive potential, and there's not that responsibility on a private operator to protect private citizens."

While Illinois officials expect the sale will attract investors, experts say that lotteries are fairly uncertain businesses.

In 2005, executives at the Multi-State Lottery Association, which runs the Powerball lottery, saw revenue drop by more than 15 percent after a record-setting run of winners kept jackpots small. The number of tickets sold increases as jackpots grow progressively bigger.

"Lottery revenues go through a lot of ups and downs, so there's a lot risk there," said Russell Sobel, a professor of economics at West Virginia University who has studied the industry. Some lotteries offer fixed prizes, regardless of how many ticketholders win. When popular combinations of numbers become winners – such as 1234, 8888 or 122500, the supposed date of the first Christmas – the number of winning tickets can spiral upwards, said Professor Sobel, reducing a lottery's profits.

Illinois Governor Rod R. Blagojevich first floated the idea of privatizing the state's lottery last May, while seeking re-election. At the time, Blagojevich estimated that the sale's would generate $10 billion, which would fund a four-year school building and education plan. Under his proposal, $6 billion would be set aside to provide the state's schools with $650 million a year for the next 18 years, roughly equal to what the schools received in lottery income.

At the time, Illinois Republicans charged that the real motivation behind Blagojevich's proposal was to keep independent state Sen. James Meeks of Chicago from entering the gubernatorial race. Meeks, an influential black leader, had threatened to challenge Blagojevich if education funding wasn't increased. Following the lottery proposal, Meeks announced he would not run.

Goldman Sachs and UBS are advising the state of Illinois. Mark Florian, a managing director in Goldman Sachs' municipal finance and infrastructure group, said demand would come from strategic bidders as well as infrastructure funds and private equity funds flush with cash.

Goldman Sachs, which has a $6.5 billion infrastructure fund, will not bid, said Mr. Filan.